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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)	
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Access Charge Reform)	CC Docket No. 96-262 ✓
)	
Price Cap Performance Review)	CC Docket No. 94-1
for Local Exchange Carriers)	
)	
Transport Rate Structure)	CC Docket No. 91-213
and Pricing)	
)	
Usage of the Public Switched)	CC Docket No. 96-263
Network by Information Service)	
and Internet Providers)	

Comments
of
The Southern New England Telephone Company

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January 27, 1997

CC Docket No. 96-296

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Summary

SNET Comments

January 29, 1997

CC Docket No. 96-296

Access Reform

SNET's comments address the need to replace current rules with a system of limited oversight that allows the *market* to drive access price levels and structure. Increasing competition for access services from both facilities-based and nonfacilities-based competitors in Connecticut requires that SNET be able to price its services, like our competitors, to meet the market's needs.

The Telecommunications Act of 1996 and Commission's Interconnection Order dramatically changed the landscape for the provision of access and other telecommunications services by removing all remaining barriers to entry. In the new environment, the combination of burgeoning access competition, the availability of access alternatives via unbundled elements, and the strong incentives ILECs have to price their networks attractively to retain usage on those networks, will prevent ILECs from controlling price for access services, and will, in fact, drive access prices to competitive levels. Accordingly, now is the time for the Commission to move to a flexible, market-based approach to access reform.

As the access market transitions to market-based pricing, ILECs should nonetheless be allowed to recover implicit subsidies embedded historically in access rates through a transitional plan. To ignore these historic subsidies would be to ignore the public policy commitments made, and obligations assumed, by ILECs over the years.

The transitional plan should be structured so that it has minimal adverse impact on the move to market-based pricing. The historical implicit subsidies -- resulting from long-standing public policy decisions, including cost over-allocations to interstate and under-depreciated investment -- were mandated to meet public policy goals and support universal service. These implicit subsidies must be made explicit, and recovered in a competitively neutral manner.

In its Comments, SNET proposes that subsidies resulting from the historical over-allocation to interstate continue to be recovered pursuant to the Commission's Part 69 Rules. SNET proposes, however, that these costs be recovered for an interim period on a "bulk billed" basis, in lieu of the current "per minute of use" structure. Once the separations rules are reviewed, these subsidies should ultimately be removed from access and reallocated appropriately to the cost-causer.

In regard to depreciation, SNET proposes that the Commission establish a mechanism to allow ILECs to recover their federal reserve deficiency on an accelerated basis. This recovery should occur outside of access rates to avoid market and economic distortions that might otherwise occur.

In sum, as the Commission transitions to a system of limited regulatory oversight that permits *market* driven access prices, it must insure that ILECs be allowed a reasonable opportunity to recover historical public policy costs, but must do so in ways that do not hinder continued development of competitive markets.

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Comments
of
The Southern New England Telephone Company

The Southern New England Telephone Company (SNET), hereby files its comments in the above captioned matters, pursuant to the Notice of Proposed Rulemaking (FCC 96-488) released December 24, 1996 (NPRM) by the Federal Communications Commission (Commission).

Increasing competition for access services from both facilities-based and nonfacilities-based competitors in Connecticut requires that SNET be able to price its services, like our competitors, to meet the market's needs. New regulations for price

cap incumbent local exchange companies (ILECs) are necessary to encourage full and fair competition for providing access services.

Accordingly, it is the right time for a flexible, market based approach to access reform. SNET's comments address the need to replace current rules with a system of limited oversight that allows the *market* to drive access price levels. Competition is here in Connecticut. The Commission should now rely on market forces to lower ILEC prices as: 1) there is current competition for access, 2) unbundled elements are substitutions for access; and 3) ILECs, like SNET, have a strong incentive to maximize the use their networks.

The Commission must decide how to regulate access in an environment that is ever changing. The Connecticut experience can serve as a model for deregulation. "[T]he less ambitious, far less interventionist option that regulators in Connecticut have exercised is delivering people's dividends today."¹

Implicit subsidies must continue to be recovered, in an explicit, competitively neutral manner. The historical allocations systems the Commission has used are no longer appropriate in a competitive environment, because prices for services must move to economic costs.

As access services transition to market-based pricing, ILECs must continue to recover their embedded costs. These costs were incurred to meet mandated public

¹ "Interview with Washington Telecom attorney Kenneth Robinson," Telco Competition Report, December 5, 1996, page 9.

policy goals in support of universal service. To enable ILECs to compete in the access market, implicit subsidies resulting from the current rules must be removed from access rates.

In addition to its comments filed today, SNET supports the detailed comments filed by the United States Telephone Association (USTA) in this proceeding.

I. INTRODUCTION

The Commission established the current access charge regime in an era when ILECs were virtually the only providers of access. In that environment, rates could sustain costs to cover mandated public policy goals. Increasing competition for access services from both facilities-based and nonfacilities-based providers requires that incumbent local exchange carriers have the ability to price their services, like their competitors, to meet the market's needs.

The Telecommunications Act of 1996² and Commission's Interconnection Order³ dramatically changed the landscape for the provision of access services by removing barriers to entry. The Interconnection Order, in fact, encourages

² Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56. *to be codified at* 47 U.S.C. §§ 151 *et seq.* (the Act).

³ In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, First Report and Order, released August 8, 1996, FCC 96-325, *petition for review pending and partial stay granted, sub nom. Iowa Utilities Board et. al v. FCC*, No. 96-3321 and consolidated cases (8th Cir. Oct. 15, 1996), *partial stay lifted in part, Iowa Utilities Board et. al v. FCC*, No. 96-3321 and consolidated cases (8th Cir. Nov. 1, 1996) (Interconnection Order), para. 292.

competitors to enter the ILEC market by permitting unbundled network elements to be combined to provide a total exchange access service equivalent to conventional access.⁴ In effect, the Commission has established a framework where new telecommunications providers need not incur high investment costs to compete. These competitors need only purchase unbundled elements that are priced on "forward looking costs."

Current ILEC access rates are unsustainable in this new environment. Burgeoning local and access service competition, in what was once the sole market of the ILECs, dictate that the Commission should establish a new regulatory structure of access charges based upon market dynamics.

As the Commission summarizes:

The Telecommunications Act of 1996 fundamentally changes telecommunications regulation. In the old regulatory regime government encouraged monopolies. In the new regulatory regime, we and the states remove the outdated barriers that protect monopolies from competition and affirmatively promote efficient competition using tools forged by Congress.⁵

The Act promotes competition by removing barriers to entry for new telecommunications carriers. However, efficient competition can only be achieved if ILECs can respond to marketplace needs. If the Commission were to implement a prescriptive approach that establishes a transition mechanism to the new regime,

⁴ Interconnection Order, paras. 356-365.

⁵ Interconnection Order, para. 1.

access customers and access providers would be unlikely to have the flexibility to respond quickly to changing circumstances. The marketplace seeks alternatives to price and product from alternative providers. Only when the ILEC can modify its price and products, as do its competitors, will efficient competition be achieved. The resulting "efficient" competition will benefit all consumers of telecommunications services through lower prices, and more choice through the introduction of new services by many companies.

A. Historical Costs Must Be Recovered In Full.

The current access charge structure is economically inefficient. First, the current rules do not allow ILECs to respond adequately to marketplace dynamics in an economic way. Secondly, rates include implicit subsidies and mandated separations misallocations. There is an historical legacy underlying today's structure that the Commission must recognize in the transition to a new structure. The costs to support this legacy need to be examined by the Commission as access moves to market-based rates.

Current access rates are based, in great part, on separations rules that allocate costs to the interstate jurisdiction. Separations rules over-allocate costs to the interstate jurisdiction to meet public policy goals that have kept local service rates low. Access rates have historically basically been a major funding source for universal service.

The Act changes the entire manner in which universal service is funded by ending the system of implicit subsidies in favor of a system of explicit subsidies.⁶

Another component of the historical structure that must be recognized is the ILECs' assets that have not been sufficiently recovered. Also linked to universal service objectives, explicit public policy intentionally prevented ILECs from establishing economic depreciation levels. Embedded assets have not been properly amortized, especially in light of emerging competition and the progress of technology.

The Commission's price cap rules have delivered considerable reductions in access rates to the interexchange carriers (IXCs). However, the Commission's price cap regime cannot be called a complete success because a large portion of end user customers --customers of the major interstate IXCs -- have not seen corresponding reductions in their interstate message toll rates. In fact, many of the major IXCs have recently increased their interstate "list price" toll rates,⁷ preventing consumers from receiving the benefits of the Commission's pro-competitive regulatory initiatives.

ILECs require necessary and immediate pricing relief. However, the industry is well aware that the rules on which its rates are based are out of date and

⁶ Telecommunications Act of 1996, Sect. 254; see also NPRM, para. 5.

⁷ See, e.g., "AT&T Hikes Rates By 5.9 Percent," The New York Times (Late City Edition), November 28, 1996, page D-1, col. 2; "AT&T and Rivals Boost Rates Further -- Move Arms Critics Who Say Long-Distance Market Needs More Competition," The Wall Street Journal (Eastern Edition), November 29, 1996, page A-3, col. 1; "AT&T Follows MCI, Sprint with Long Distance Rate Increases," Telecommunications Reports, Vol. 62, No. 48, December 2, 1996, pg. 5.

burdensome. New rulemaking proceedings to re-examine these historical costs in this competitive environment should be initiated as soon as possible.

B. SNET's Earnings Are Particularly Vulnerable Without Pricing Flexibility.

While price cap regulation was mandated for the RBOCs and GTE, and remained optional for smaller companies, SNET elected price cap regulation in 1991. SNET has earned within the target return range since its election of price caps, never reaching profit levels in the sharing range. Like the larger price cap company companies, SNET is now faced with serious competition and must be able to respond to customer needs to achieve its earnings. As competition for access services accelerates, unless SNET obtains necessary pricing flexibility to meet customer needs, SNET's earnings are extremely vulnerable.

As its access revenues decline in the future, SNET does not have sufficient revenues from its long distance business that could offset the loss. By contrast, the large LECs will offset the loss with revenue from their future offering of long distance services. For these companies the transition to a new cost based structure for access will be significantly less disruptive than for SNET. SNET's service area includes only a single state with two million access lines. SNET's small size contrasts with the much greater size of the RBOCs, with facilities and operations that span many states. As the RBOCs enter the long distance business, they can expect a significant new revenue stream, due to their extensive span of operations.

To satisfy its goal of promoting competition, and the goals of the Telecommunications Act, the Commission must move towards an approach to regulation that relieves the ILECs from stringent, prescriptive access regulations to a market-based approach for regulating access service prices. In addition, ILECs must be compensated for their embedded costs associated with public policy goals of the past.

In sum, Connecticut's competitive environment requires that SNET be able to offer its customers services at competitive prices. All ILECs, including SNET, will need sufficient pricing flexibility to achieve future earnings, if the Commission's goal of a robust, competitive access market is to be maintained.

II. SIGNIFICANT CHANGES IN THE TELECOMMUNICATIONS ENVIRONMENT REQUIRE THE COMMISSION TO CHANGE HOW IT REGULATES ACCESS. (NPRM, paras. 140-160.)

The Commission properly recognizes that changes in the telecommunications environment precipitated by the Act now require changes to access charge rules. The Commission seeks to adopt rules that will foster competition for access services and enable marketplace forces to eliminate the need for price regulation.⁸ SNET supports the Commission's suggestion that a market-based approach to access reform could be implemented incrementally, based upon certain defined criteria for an ILEC to make a verifiable "showing." Expeditious rule changes that relax pricing restrictions imposed on the ILECs will benefit consumers. With a "level playing field" that allows ILECs to compete with other providers of telecommunications services, ILECs are encouraged to continue investing in new technologies and infrastructure.

SNET is already experiencing substantial competition from alternative providers not encumbered by artificial pricing rules and regulations. The Commission should not wait to make regulatory changes for price cap ILECs based on the measure of lost market share, as it did in the case of AT&T. There are four factors to consider that differentiate the ILEC situation from AT&T's.

First, unlike long distance end users, access customers' revenues are far more concentrated and much less flexible. The loss of one major access customer

⁸ NPRM, para. 140.

represents millions in revenues. Unlike end users, access customers cannot be easily "won back" with a one-time check offer.⁹ Access customers are constantly evaluating their network requirements and price alternatives. ILECs must be able to propose options to customers in a meaningful time frame. Any delay resulting from regulatory constraints, i.e. waiver requests, or petitions, withholds alternatives that may meet a customer's need. These constraints also prevent ILECs from introducing new and innovative services that can spur new market niches and encourage other providers to enter the market.

Second, access customers, unlike most end users, are extremely sophisticated about the market. They know what is available at what price, and where. The education process that took years in the consumer market is simply unnecessary here.

Third, SNET's access competitors are established companies that are already providing access service. Unlike the early years of the AT&T toll experience, SNET's competitors are not "start-ups" or "fly by night" ventures. They have the ability to capture a significant portion of SNET's business.

Finally, as CLECs are successful in capturing a large local market share, they will have an economic incentive to deploy their own switches and facilities in lieu of utilizing the ILEC's network.

⁹ In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Notice of Proposed Rulemaking, FCC 95-393, released September 20, 1995 (Price Cap Flexibility NPRM), SNET Comments filed December 11, 1995 (SNET's Pricing Flexibility Comments), pgs. 3-4.

SNET encourages the Commission to recognize and differentiate between the ILEC situation and the AT&T experience, and accelerate the pace of deregulation for the ILECs.

A. Connecticut Has Been Progressive In Fostering Competition.

The Connecticut experience introducing competition has put the State -- and SNET as the major ILEC -- out in front of the transition to full competition.

On July 1, 1994, Public Act 94-83, "An Act Implementing The Recommendations Of The Telecommunications Task Force" (Public Act), became Connecticut law. The Public Act allows certified local exchange carriers (CLECs) to provide local exchange services through their own facilities or through the resale of the incumbent local exchange carrier's local exchange facilities. The Public Act empowered the Connecticut Department of Public Utility Control (CDPUC) to define and administer the technical and procedural components of telecommunications competition within Connecticut. The CDPUC has initiated and completed numerous proceedings to implement the legislation. SNET has worked cooperatively for more than two years to implement full competition within Connecticut. The CDPUC has approved or mandated: 1) interim unbundled and wholesale rates; 2) interim mutual compensation rules for local exchange providers; 3) number portability. The CDPUC has also undertaken other initiatives to implement competition, such as establishing rules that reclassify services from "non-competitive" to "competitive" as the market

dictates, and has approved an alternative regulation plan for SNET. In addition, SNET has completed the conversion of 100% of its central offices to intrastate equal access.

Over a year and a half ago, the CDPUC commented that:

What sets Connecticut apart, aside from the sweeping nature of its competitive offerings, is the manner in which it has undertaken its regulatory responsibilities. Following the 1994 legislation, the DPUC undertook numerous cases to first establish policy and then procedures for the implementation of competitive Telecommunications services. It set up its "vision" for the competitive Telecommunications environment and has vigorously pursued goals to make that vision a reality. Already addressed in prior proceedings are issues regarding the criteria necessary for certification as a competitive provider and making competitive service available statewide, even in the less populous areas.¹⁰

Virtually all of SNET's telecommunications and access services are subject to actual competition. SNET now needs the ability to price its interstate access services competitively, or it is placed at an economic and competitive disadvantage.

B. Competition in Connecticut Necessitates Expeditious Changes In The Commission's Rules.

The competition that the Connecticut State Legislature intended has arrived. A recent headline in USA TODAY highlights the competitive environment in Connecticut: "AT&T has vowed a "local phone war" in Connecticut."¹¹

¹⁰ DPUC NEWS LINE, released September 22, 1995.

¹¹ USA TODAY, January 22, 1997, pg. 1. See also, e.g., "State telecom battles to sizzle in 1997," New Haven Register, January 28, 1997, Section D "Outlook '97," pg. 1.

Consumers in Connecticut already have many telecommunications choices available, and additional alternatives are appearing almost daily. The CDPUC has established a new regulatory regime for Connecticut that encourages competition in all market segments. It has a process in place for CLECs to obtain certification for entry into the Connecticut market.

Nineteen CLECs have applied to the CDPUC for certificates of public convenience and necessity to provide local telephone service. To date, the CDPUC has approved seventeen of these applications. These CLECs include some of the largest and best financed telecommunications corporations in the world, and already have relationships with Connecticut customers by virtue of their interstate products.¹² As shown in Exhibit 1, several of these CLECs also provide switched access services in direct competition with SNET.

SNET is currently negotiating with twelve of these telecommunications companies for interconnection to its network. To date, SNET has negotiated interconnection agreements with TCI, AT&T, Brooks Fiber, MCI Metro, and TCG. SNET is currently negotiating with the remaining CLECs.

In addition, in March 1996, Northeast Utilities announced that it will form a subsidiary to be a joint owner in FiveCom, Inc., an innovator in fiber optic networks to create a regional state of the art telecommunications system.

¹² See, Exhibit 1, entitled "Certified Local Exchange Carriers In Connecticut," for a summary these applications.

Also, Brooks Fiber has announced that through their "ultra-modern 5ESS switch" activated in June 1996, they will offer businesses a full array of telecommunications services that can be used to supplement or bypass the services offered by SNET.¹³

The intrastate toll market within Connecticut is very competitive indeed. A total of 239 Applications for Certificates of Public Convenience and Necessity have been filed with the CDPUC by carriers offering intrastate toll services, and 145 have been approved.¹⁴ In order to respond to this highly competitive intrastate toll market, SNET applied to the CDPUC for reclassification of its intrastate toll products to "competitive;" the CDPUC has approved SNET's application.¹⁵

The bottom line is clear: SNET is no longer "the only game in town." The Connecticut marketplace has clearly moved ahead on the competitive continuum, just as Public Act 94-83 and the Act intended. The Commission need not hesitate in enacting progressive, deregulatory, procompetitive access reform regulations.

¹³ PR Newswire, June 17, 1996.

¹⁴ SNET also attaches to these comments Exhibit 2, entitled "Companies Seeking Certificates of Public Convenience and Necessity: Intrastate Toll."

¹⁵ APPLICATION OF THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY FOR APPROVAL TO RECLASSIFY MESSAGE TOLL SERVICE FROM NONCOMPETITIVE TO COMPETITIVE, Docket No. 96-06-23, Decision, November 27, 1996.

C. SNET Must Be Able To Respond To Its Access Customers In Both The Intrastate And Interstate Jurisdictions.

SNET's access customers are now actively making choices for their immediate and future access services needs. SNET must respond to its customers in the same manner in which its competitors can respond. Customers are pressuring SNET to respond to their needs and, therefore on August 1, 1996, SNET filed a Petition For Expedited Waiver of the Commission's Part 69 Rules to offer a new, optional rate plan for interstate switched access service, called "Commitment Discount Plan."¹⁶ SNET filed this waiver to establish a plan that 1) meets its customers needs to reduce and stabilize their access service costs, and 2) helps SNET use its switched access infrastructure as efficiently as possible and retain customers on its network. This plan offers customers immediate and future switched access rate discounts from current switched access rates based upon a commitment to use SNET's network for a specific term.

SNET filed this optional rate plan with the CDPUC on September 3, 1996 to be able to offer rate reductions and stabilization for intrastate access. That tariff took effect, as filed, on September 24, 1996. The real value to SNET's customers, however, is lower rates, stabilized for both state and interstate access. SNET has responded in yet another way to reduce customer's costs and has filed a tariff with

¹⁶ In the Matter of The Southern New England Telephone Company, Petition for Waiver of Part 69 of the Commission's Rules to Offer a Switched Access Discount Plan, filed August 1, 1996.

the Connecticut DPUC to offer even further discounts to customers based upon the customer's commitment to use SNET's services. This state tariff also took effect on January 23, 1997. SNET has not filed this plan with the Commission, as the Commission has not acted upon its first Petition, and SNET is hopeful that access reform will permit SNET the flexibility it needs to respond to customer's needs.

III. SNET SUPPORTS A MARKET-BASED APPROACH TO ACCESS REFORM.
(NPRM, paras. 247-270.)

The Commission outlines a framework for a market-based approach to deregulating ILECs' exchange access services as competition develops in the local exchange and exchange access market. Under this approach, the Commission would "relax and ultimately remove existing Part 69 rate structure requirements and Part 61 restrictions on rate level changes as marketplace forces provide the discipline on LEC access prices that our rules are currently needed to apply."¹⁷

The Commission recognizes that its price cap regulatory plan for ILECs was designed to simulate some of the efficiency incentives found in competitive markets and to act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.¹⁸

Maintaining prescriptive rules that restrain pricing and service introductions in a competitive environment has serious implications. Harm is caused to both consumers and incumbents. It is now time to transition to a plan that allows market forces to determine the pace of reform. SNET should be allowed to compete based upon its inherent abilities to provide efficient, cost effective services to meet customer needs. SNET's success should be determined by the marketplace, not by regulatory rules.

¹⁷ NPRM, para. 14.

¹⁸ NPRM, para. 30, footnote 50.

A. The Commission Should Phase In Flexibility For ILECs To Reflect Market Conditions.

The Commission proposes two intermediate steps toward providing ILECs with flexibility before being deregulated. These steps can be reached upon certain "triggers" being met by ILECs.

SNET agrees with the Commission that as markets become more competitive, regulatory oversight should be reduced. SNET supports USTA's procompetitive and deregulatory plan that establishes an accelerated approach for access reform, given the current level and rapid advances in telecommunications competition. USTA recommends that at the first phase of reform, the Commission grant ILECs pricing flexibility to allow: 1) contract tariffs, 2) a simplified price cap basket structure to consolidate baskets and service categories, 3) volume and term discounts, and 4) a restructure of Part 69 rules. The second phase would allow ILECs to remove certain access services from regulation in geographic areas, allowing market forces to determine price. Forbearance from regulation would be based upon meeting the criteria of Section 10(a) of the Act.

SNET agrees with the approach outlined by USTA, that the Commission transition to a market-based approach as follows:

Phase 1:

The Phase 1 trigger should be applied when a state has complied with Section 251(b) and (c), which requires ILECs to provide resale, number portability,

dialing parity, access to rights of way, reciprocal compensation, interconnection with the ILEC network, unbundled access to network elements, and collocation. When these conditions are met in the state, barriers to entry are removed, and the market is open to competitors.

At this point, ILECs need additional pricing flexibility, including the ability to deaverage switched access rates by geographic area, to offer volume and term discounts to customers, to offer contract tariffs and responses to RFP proposals. In addition, new access services should be offered out of regulation. There is no need to impede the introduction of new services through regulation. The introduction of new services, offering customers the benefits of new technology, need not be hampered.

The price cap structure needs to be changed, and simplified. As USTA comments in greater detail, the new structure should have only one basket, with four service categories that permit "zone pricing." This simplified structure is needed to recognize the competitive alternatives available to customers now.

Part 69 rules severely limit the ILECs ability to respond to competition. ILECs need the ability to establish rate plans and rates to meet customer needs. As SNET has previously commented, LECs should be able to establish a rate structure for a given service to respond to marketplace needs, not mandated requirements by the Commission. Continuing the requirement to file waivers to establish Part 69 rate